SUPREME COURT, U.S.

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No. [redacted]

In the Supreme Court of the United States

OCTOBER TERM, [redacted] 1970

UNITED STATES OF AMERICA, APPELLANT

v.

MARYLAND SAVINGS-SHARE INSURANCE CORPORATION

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND

REPLY BRIEF FOR THE UNITED STATES

ERWIN N. GRISWOLD,
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In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 1575

UNITED STATES OF AMERICA, APPELLANT

v.

MARYLAND SAVINGS-SHARE INSURANCE CORPORATION

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND

REPLY BRIEF FOR THE UNITED STATES

1. The court below held an Act of Congress unconstitutional. If such a result is required, it should be reached only after a full hearing in this Court.

2. The court below held Section 501(c)(14)(B) of the Internal Revenue Code unconstitutional because it could not find (J.S. App. A, p. 34) "any conceivable basis in fact" for the exemption of mutual insurers organized before September 1, 1957, and the taxation of those organized on or after that date. We have shown (J.S. 9–10) that there is a basis for the difference in treatment—preventing a proliferation of state-authorized insurance corporations which might adversely affect the Federal Savings and Loan Insurance Cor-

poration ("FSLIC"). The appellee has undertaken to discredit this purpose. While it concedes (Motion 7) that "it is Congress' prerogative to protect FSLIC * * *" it contends (*ibid.*) that a congressional purpose to "deter the formation of state mutual insurers * * * is an impermissible one * * *" and that "Congress may not deter the formation of state mutual insurers in order to protect the interests of their federal counterpart."

This argument obviously raises serious questions in the field of federal-state relations. Moreover, it does not rest on any question of discrimination between appellee and state mutual insurers organized before September 1, 1957, but rather on an alleged absence of congressional power to subject state mutual insurers, no matter when organized, to the general income tax. In other words, appellee is in the position of arguing that Congress is constitutionally compelled to extend a tax exemption to each state insurer on the date of its formation, because, not to do so, would deter the formation of additional state insurers.[1]

Congress unquestionably has the power to make the general income tax applicable to all state mutual insurers. It is not proper to view the general income

[1] This is not unlike appellee's alternative contention, pressed below and renewed in its Motion (pp. 12–14), that it is a state instrumentality exempt from tax under the doctrine of intergovernmental immunity. That contention and appellee's further claim (Motion 14–15) that its income is excludable from gross income under Section 115(a)(1) of the Internal Revenue Code were properly rejected by the court below. See J.S. App. A, pp. 17–25.

tax as a penalty, as appellee's argument implicitly assumes. So long as imposition of the tax is within Congress' taxing power and does not contravene any other provision of the constitution, that is sufficient to sustain its validity. Moreover, given Congress' undisputed fiscal power to create FSLIC, imposing the general income tax on state insurers to protect that federal instrumentality is within the scope of the necessary and proper clause. See *M'Culloch* v. *Maryland*, 4 Wheat. 316, 419; *Agricultural Bank* v. *Tax Comm'n.*, 392 U.S. 339.

Hopkins Savings Assn. v. *Cleary*, 296 U.S. 315, cited by appellee (Motion 7), is not to the contrary. In that case, the Court held (*id.*, p. 335) that Section 5(i) of the Federal Home Owners' Loan Act of 1933 encroached upon the reserved powers of the states in violation of the Tenth Amendment, insofar as it permitted the conversion of state savings and loan associations into federal associations in contravention of the laws of the state of their creation. *Hopkins Savings* cannot be read to mean that the federal government is constitutionally bound to foster the development of state savings and loan associations, much less state insurers of such associations. It held only (296 U.S. at p. 336) that, in those circumstances, Congress was without power "to put an end to corporations created by the states and turn them into different corporations created by the nation." Indeed, the Court recognized (*id.*, p. 338) that the result would be different "where the business of an association under charter from a state is conducted in such a way as to be a menace or obstruc-

tion to the legitimate activities of its federal competitors."

There is no question here involving a congressional attempt to put appellee or any other state mutual insurer out of business. What is at issue is congressional power to withhold the ultimate tax privilege—tax exemption—in a situation where the state insurers are not in competition with each other. Moreover, we have here, unlike the situation in *Hopkins Savings*, a clear indication that proliferation of state mutual insurers could prove "a menace or obstruction to the legitimate activities" of FSLIC. See Statement by Joseph P. McMurray, Chairman, Federal Home Loan Bank Board, in Hearing before the Senate Committee on Finance on H.R. 3297, 88th Cong., 2d Sess., pp. 9–10 (set out in J.S. App. E, pp. 45–49). Under these circumstances, appellee cannot escape the conclusion that there is a basis for the classification in Section 501(c)(14)(B) by reliance on the Tenth Amendment. "From the beginning and for many years the amendment has been construed as not depriving the national government of authority to resort to all means for the exercise of a granted power which are appropriate and plainly adapted to the permitted end." *United States* v. *Darby*, 312 U.S. 100, 124.

3. In holding that appellee was entitled to the refund of taxes here in dispute, the court below assumed, without discussion, that if Section 501(c)(14)(B) is unconstitutional, the proper remedy would be to extend the exemption to appellee by excising the cut-off date from the statute, rather than by

declaring the entire section a nullity. This assumption we believe to be unwarranted.[2] But whether warranted or not, the issue is not one that should be decided *sub silentio*. The concurring and dissenting opinions in *Welsh* v. *United States*, No. 76, this Term, decided June 15, 1970, show that the question of the appropriate remedy for an unconstitutional underinclusion in a statute is both difficult and important. It is one on which this Court should hear argument even if it were to conclude that Section 501(c)(14)(B) is unconstitutional.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

MATTHEW J. ZINN,
Assistant to the Solicitor General.

JUNE 1970.

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[2] Appellee's argument (Motion 10–12) that the original cut-off date in Section 501(c)(14)(B), September 1, 1951, was not a significant aspect of the legislation is negatived by the fact that when Congress amended the statute in 1960 to include the Ohio Deposit Guaranty Fund, it did not eliminate the cut-off date completely. It merely changed the date to September 1, 1957. See J.S. 8–9. Furthermore, the bill which appellee itself sponsored, when it sought legislative relief likewise did not provide an open-ended exemption, but limited the exempt class to those—including appellee—organized before January 1, 1963. See J.S. 9.

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PER CURIAM

SUPREME COURT OF THE UNITED STATES

October Term, 1970

UNITED STATES *v.* MARYLAND SAVINGS-SHARE INSURANCE CORPORATION

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND

No. 160. Decided October 19, 1970

PER CURIAM.

This is a direct appeal by the United States from a district court judgment holding unconstitutional § 501 (c)(14)(B) of the Internal Revenue Code of 1954, 26 U. S. C. § 501 (c)(14)(B), on the ground that it arbitrarily discriminates between Maryland Savings-Share Insurance Corporation (MSSIC), the appellee, and other similar nonprofit, mutual insurers.

MSSIC was established by the Maryland Legislature with the object of insuring the accounts of shareholders of member savings and loan associations. Although first chartered in 1962, it seeks the benefit of § 501 (c)(14)(B), which exempts from tax nonprofit corporations such as petitioner but only if organized before September 1, 1957.[1] MSSIC's position is that September 1, 1957 is an arbitrary and unconstitutional cutoff date which must be excised from the section, leaving the section applicable to all corporations of the same nature as itself regardless of the date of their creation. We do not agree.

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[1] Internal Revenue Code § 501 (c)(14)(B), 26 U. S. C. § 501 (c)(14)(B), provides:

"(B) Corporations or associations without capital stock organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for, and insurance of shares or deposits in—

"(i) domestic building and loan associations,

"(ii) cooperative banks without capital stock organized and operated for mutual purposes and without profit, or

"(iii) mutual savings banks not having capital stock represented by shares."

Prior to 1951, all savings and loan associations were exempt from taxation of income derived from their operations. Also exempt were nonprofit corporations which insured the savings banks. In 1951, the savings bank exemption was discontinued, on findings that the industry had developed to a point comparable to that of commercial banks. The exemption for insurers, however, was continued, provided they were already in existence as of September 1, 1951. See Revenue Act of 1951, § 313 (b), 65 Stat. 490; S. Rep. No. 781, 82d Cong., 1st Sess., 2 U. S. Code. Cong. & Ad. News 1969, 1991–1997 (1951). As of that date three private insurers fell within the scope of the section—two of them in Massachusetts and one in Connecticut. Then, in 1956, a fourth such corporation was organized in Ohio, and four years later Congress moved the cutoff date forward to September 1, 1957. Act of April 22, 1960, 74 Stat. 54.

In 1963, a similar bill, H. R. 3297, 88th Cong., 1st Sess., which would have moved the cutoff date forward to January 1, 1963, for the benefit of MSSIC, passed the House, but was never reported out by the Senate Finance Committee. Testimony before the committee indicated that continued forward movement of the date might lead to proliferation of state insurers that could hinder the operations and threaten the financial stability of the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation. See Hearing before Senate Committee on Finance on H. R. 3297, 88th Cong., 2d Sess., 9–10 (1964).

Against this background, the District Court's invalidation of § 501 (c)(14)(B) was error. The fact that Congress enacts a statute containing a "grandfather clause," which exempts from the general income tax certain corporations organized prior to a specified date, does not of itself indicate that Congress has made an arbitrary classification. Cf. *Stanley* v. *Public Utilities Comm'n*, 295 U. S. 76 (1935); *Sperry & Hutchinson Co.* v. *Rhodes*, 220 U. S. 502 (1911); *Watson* v. *Maryland*, 218 U. S. 173

(1910); *Sampere* v. *New Orleans*, 166 La. 776, 117 So. 827 (1928), aff'd *per curiam*, 279 U. S. 812 (1929). Normally, a legislative classification will not be set aside if any state of facts rationally justifying it is demonstrated to or perceived by the courts. *McDonald* v. *Board of Election Comm'rs*, 394 U. S. 802, 809 (1969); *McGowan* v. *Maryland*, 366 U. S. 420, 426 (1961); *Standard Oil Co.* v. *City of Marysville*, 279 U. S. 582, 586–587 (1929). See also *Watson* v. *Maryland*, *supra*, at 178. Here the legislative history of H. R. 3297 affirmatively discloses that Congress had a rational basis for declining in 1963 to broaden the exemption by extending the cutoff date of § 501 (c)(14)(B). Just as a State may provide that after a specified date newly established common carriers must obtain state approval before entering into business so as to prevent proliferation of such carriers and excessive use of the State's highways, see *Stanley* v. *Public Utilities Comm'n*, *supra*, similarly Congress does not exceed its power to tax nor does it violate the Fifth Amendment when it refuses to exempt from tax newly formed corporations, the multiplication of which might burden otherwise valid federal programs.[2]

Having noted probable jurisdiction by order of October 12, 1970, we now reverse the judgment of the District Court.

So ordered.

MR. JUSTICE HARLAN, considering that the issues in this case are deserving of plenary consideration, would set the case for argument.

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[2] The District Court's reliance on *Mayflower Farms, Inc.* v. *Ten Eyck*, 297 U. S. 266 (1936), was misplaced, since, according to the Court in that case, the legislative record contained no affirmative showing of a valid legislative purpose. We thus need not pass upon the continuing validity of *Mayflower's* holding. We also find unpersuasive MSSIC's remaining argument that it is an instrumentality of the State and hence entitled to exemption from federal taxation under the doctrine of intergovernmental immunity and under § 115 (a)(1) of the Code, 26 U. S. C. § 115 (a)(1). The District Court properly rejected these arguments.